Agriculture Financial Services Corporation's (AFSC)

QUARTERLY REPORT

2015-16

(Third Quarter Update - December 31, 2015)

AFSC is in the business of helping Albertans achieve prosperity and build successful businesses.

Nature of Operations

Overview

Economic Climate

Alberta's economy remained depressed through the third quarter due to ongoing difficulties in the energy sector. International markets reacted negatively to the continuing issues of economic slowdown in China and international over-production of oil, pushing the value of crude to a low of $34.55 USD/bbl in December. Alberta's energy sector continued to postpone investments and lay off staff in an effort to reduce costs. Unemployment in the province grew only slightly as other sectors continued to hire. Newly-created jobs, however, were generally for less pay and fewer hours as compared to jobs lost in the energy sector. Both forestry and tourism showed a strong performance over the quarter.

The loonie followed the same trajectory as the price of oil, falling to a low of $0.71 USD in December. The depressed Canadian exchange has acted as a hedge for Canadian producers, as most international agricultural prices remained flat or fell over the quarter. As most commodities are priced in US dollars, the low exchange rate is keeping Canadian agricultural products competitive on the world stage. This situation is in sharp contrast to the United States, where producers are being priced out of world markets because of the American dollar's high value. American producers are expected to face the largest decline in returns on agricultural production since the 1980s. Returns on Canadian agriculture remain positive as producers receive more Canadian dollars for goods exported to international markets.

Annual Crop Conditions

The wet weather that led into the third quarter followed through to October and delayed the harvest in many areas of Alberta. By the middle of October, the weather started to cooperate with farmers, allowing harvest to progress to 87 per cent complete throughout the province. The first part of November saw harvest essentially finished with 99 per cent of crops in the bin. Even with the long and open fall, clients were challenged with frequent rainfall, generally damp conditions and uneven crop growth due to late germination.

Provincially, yields for both spring and durum wheat decreased from 48.4 and 42.2 bu per acre respectively in 2014 to 44.1 and 34.5 bu per acre, but were estimated to be 86 and 85 per cent of their five-year averages. Barley and canola were up to 66.6 and 41.3 bu per acre in 2015, compared to 63.9 and 38.5 bu per acre in 2014, and were estimated at 90 per cent and 95 per cent of the five -year average. Oats decreased from 77.7 bu per acre in 2014 to 64.4 bu per acre and was at 86 per cent of the five-year average. Field peas also showed a decrease from 41.5 bu per acre in 2014 to 32.1 bu per acre, and were at 80 per cent of the five-year average.

Crop quality declined due to the wet weather - which caused some crops to sprout - but overall quality was above average compared to the five-and 10-year averages for most crops. More than 76 per cent of spring wheat was graded as number 2 or better, up 15 per cent from the five-year average. Durum wheat quality was graded at 85 per cent for the top two grades, up 18 per cent from the five-year average. There were several exception's including malt barley, oats and canola. Only 13 per cent of barley was eligible for malt, down four per cent from the five-year average. Fifty-eight per cent of oats were graded in the top two grades, down 23 per cent. Canola declined 12 per cent from the five-year average, though 80 per cent graded number 1.

Due to long and open conditions, fall-seeded crops did fairly well in comparison to what they were earlier in the summer, when only 68 per cent were rated as "Good" or "Excellent", well below last year's 85 per cent rating.

Perennial Crop Conditions

Although the fall was open, rains delayed the crop harvest. However, they did benefit the hay and pasture fields because it gave them a chance to recover from the summer's dry conditions. The dry conditions did have an effect on the hay crop harvest, with the provincial average of 1,499 pounds per acre well below last summer's average of 3,005 pounds (49.9 per cent of 2014's yield).

By the end of the third quarter, winter snow packs were generally below-normal for the time of year. This may have an effect on available spring soil moisture; most areas' surface soil moisture is below normal, with 52 per cent of the province reporting "Good" or "Excellent", compared to 58 per cent of areas last year.

The hardest hit area for sub-soil moisture was the northwest, where only 12 per cent was "Good" or "Excellent". The Peace area followed closely behind at 13 per cent. Provincially, only 37.8 per cent of sub-soil moisture was rated "Good" or "Excellent", in comparison to 55 per cent in 2015.

Corporate

Agriculture Financial Services Corporation (AFSC) launched its new online client survey tool in November. The first survey targeted Annual Crop Insurance Program clients who were in a claim situation; 1006 clients were randomly selected to participate, and 295 total clients responded to the survey. Of those, 95 per cent of clients reported that they were satisfied with the service they received during the claim process.

As AFSC continues its journey to become client-centric, an important next step for our corporation is to review how we capture and analyze the voice of our clients. In the second quarter, AFSC began to collect client feedback and started to share this information internally to better serve clients. This work continued during the third quarter. In conjunction with this, AFSC introduced an internal formal escalation process that will enhance the client experience and ensure concerns are addressed in a timely manner by the appropriate staff member.

AFSC is working with the Alberta Alfalfa Seed Commission on a request to develop a winterkill coverage product for pedigreed alfalfa grown for seed. As a result of this work, AFSC is amending the Annual Insurance Program to make winterkill a designated peril in the year that the winterkill takes place.

As part of a review of the Bee Overwintering Program, and in consultation with the Alberta Beekeepers Commission, AFSC will implement individual coverage to this insurance program. Coverage will be based on a client's own experience, require a 10 per cent deductible and use a fixed provincial hive price. Clients will also receive a premium discount or surcharge based on their loss experience.

AFSC is also collaborating with Organic Alberta in order to develop a solution for organic farmers that will work similar to the traditional Production Insurance Program. In this new approach, certified organic producers will no longer be assessed for uninsured causes of loss, provided the guidelines established by the Organic Standard and the Insuring Agreement are both followed.

A working group including staff and board members from the Alberta Barley Commission, AFSC staff, maltsters and producers was formed to develop a new end-use option for malt barley insurance. This new option will provide more coverage for producers who specifically grow barley for a malting end use.

The need for a change to field pea insurance pricing was heard from multiple sources, including AFSC clients and the Alberta Pulse Growers. Field pea insurance pricing has transitioned over time to reflect the ratio of edible and feed peas grown in the Province. In 2016, AFSC will continue the trend and transition from a 70 per cent edible to 30 per cent feed-price ratio, to a 100 per cent edible pea end use price. The change will include an increase in the crop's guaranteed quality.

A distinct, separate insurance category for yellow dry beans will be created for 2016. The enhancement was created through efforts of the Alberta Pulse Growers and AFSC. Changes will provide more accurate insurance coverage for both yellow dry beans and beans in the "black/other" category.

In 2015, AFSC clients and the industry communicated a need for changes to fall price sources and methodologies for crops with sources farther away from and less reflective of Alberta markets. For 2016, fall prices used for Variable Price Benefit and Spring Price Endorsement for Wheat, Canola and Field peas will be created from the Price and Data Quotes system (PDQ). PDQ is a new price and market information source offered through an Alberta Wheat Commission, FARMCo and AgriRisk Initiative (a Federal government program). The new source will better reflect prices that AFSC clients are exposed to in Alberta.

Quarter Update

Lending

AFSC authorized $414.8 million in new and direct loans and guarantees for the nine-month period ending December 31, 2015, compared to $378.2 million for the same period ending December 31, 2014. This lending facilitated an investment of $604 million in the province's agriculture, agri-industry and value-added sectors.

The lending portfolio during the first three quarters of the 2015-16 fiscal year was $2.17 billion. This is up slightly from $2.07 billion for the same period last year. The lending operating cost for that same period was 0.88 per cent of the loan portfolio. The annual target for 2015-16 year is 1.2 per cent.

Alberta Farm Loans and Revolving Loans were up significantly in the first nine months of the 2015-16 fiscal year compared to the same period last year – 8.1 per cent and 67.3 per cent respectively. Commercial lending also increased by 1.8 per cent. The Value Added and Agribusiness Program (VAAP) slightly decreased by 11.6 per cent compared to the same period last year. The overall number of loans is up from the 2014-15 fiscal year.

Farm lending through the Alberta Farm Loan Program continued to be strong. This strength is attributed to better-than-expected crops across the province earlier in the year and high cattle prices. These factors also contributed to low farm arrears, which remained at 0.6 per cent for the 2015-16 fiscal year; this is consistent with the 2014-15 fiscal year.

Commercial lending increased slightly during the first nine months. Continued low oil and gas prices and the slowdown in the Alberta economy are contributing factors. AFSC is seeing a trend in client requests for interest-only periods and re-amortization. Commercial and VAAP arrears have increased to 8.7 per cent from 4.6 per cent in 2014-15.

Under the Specific Loan Guarantee Program for Feeder Associations, AFSC processed 25 applications - either initial or renewals- in the third quarter for a total of $12.5 million. There are currently 24 separate guarantees outstanding under this program for a total of $14.3 million. The Minister of Agriculture and Forestry approved a reduction of the guarantee fees from 3 per cent to 1.1 per cent, which came into effect October 1, 2015. This resulted in a total of $29,355 refunded in fee rebates back to the Associations.

A total of $125,089 interest rate rebates were paid out to the Alberta Flood Recovery programs in the third quarter, bringing the total paid amount to $1.17 million.

Lending

	Lending volume for year		Portfolio loans outstanding	
	Number of loans	Amount lent ($M)	Number of loans	Amount outstanding ($M)
2015-16 (3rd quarter)				
Farm	1,349	320.93	10,883	1,750.44
Commercial	102	61.17	887	270.52
Value-Added and AgriBusiness	57	27.68	400	151.70
Total	1,508	409.78	12,170	2,172.66
2014-15 (Annual)				
Farm	1,777	400.05	10,670	1,634.98
Commercial	172	77.68	926	276.63
Value-Added and AgriBusiness	84	45.14	410	165.88
Total	2,033	522.87	12,006	2,077.49
2013-14 (Annual)				
Farm	1,770	391.59	10,386	1,487.61
Commercial	232	95.54	1,008	302.31
Value-Added and AgriBusiness	102	63.94	405	169.41
Total	2,104	551.07	11,799	1,959.33
2012-13 (Annual)				
Farm	1,857	384.93	9,969	1,366.17
Commercial	258	115.39	1,018	280.97
Value-Added and AgriBusiness	103	52.58	362	142.56
Total	2,218	552.90	11,349	1,789.70

M=Million

Lending Operating Results

	2015-16 Target	2015-16 (3rd qtr.)	2014-15 (Annual)	2013-14 (Annual)	2012-13 (Annual)
Annual lending volume ($M)	558	410	523	551	553
Loans outstanding ($M)	2,276	2,173	2,077	1,959	1,790
Admin. cost ($M)	24.81	18.82	24.51	22.97	23.01
Write-offs ($M)	**	0.84	3.5	1.75	8.34
Operating surplus [deficit]	0	2.52	4.51	12.53	[4.00]

M=Million
**To be determined as information becomes available.

Lending Delivery Effectiveness

	2015-16 Target	2015-16 (3rd qtr.)	2014-15 (Annual)	2013-14 (Annual)	2012-13 (Annual)
Portfolio growth (% year over year)	10	4.6	6.1	9	11
Operating costs (% of portfolio)	1.2	0.89	1.18	1.17	1.29
Write-offs (% of portfolio)	**	0.04	0.17	0.09	0.47

**To be determined as information becomes available.

Insurance

Both the Perennial Insurance Program (October 15) and the Annual Insurance Program (November 15) deadlines for clients to submit their Harvested Production Reports (HPRs) occurred in this quarter. There were 4,054 annual crop post-harvest inspection requests created, which were based on clients who reported a production shortfall on their HPRs. The production shortfall was a result of dry conditions in some areas and grade loss in other areas that was caused by sprouting crops. 2,200 of these inspections are completed, resulting in approximately $90 million paid to clients; this compares to 1,314 inspections completed, paying $22.3 million in the same quarter last year.

Once fall prices were calculated in November, the Variable Price Benefit provided $26.8 million of payment on Durum Wheat, Barley, Oats, Rye, Triticale, Corn, Chickpeas, Silage Greenfeed and the Hay and Pasture Insurance Programs. The first round of the Spring Price Endorsement ran in December, paying out $1.66 million to clients who grew Beans and Sunflowers.

The dry summer conditions produced an additional 443 hay post-harvest claims, which resulted in 619 indemnities paid this quarter for a total of $7.3 million and raised the total for the year to $9.4 million. Pasture and area-based insurance final payments were made during the quarter. The Satellite Yield Insurance Program paid out an additional $7 million, raising the total to $10.1 million, and the Moisture Deficiency Insurance Program paid $7.4 million, totaling $39.9 million.

The long and open fall harvesting delays also gave Alberta wildlife additional time to graze on mature crops still in the fields. There was an additional 139 claims since the second quarter totaling 731 for the year. Of those claims, 670 were completed for a payout of $6 million, compared to 533 claims and $4.8 million last year.

Hail Endorsement payments were finalized, with 3,380 subscriptions reporting a loss. This resulted in 4,590 inspections, totaling $205.3 million in payments; this compares to last year's 3,954 subscriptions and payments of $250.8 million.

AFSC was conscious of the need to produce quick turnaround times, and posted its progress weekly during the busy fall and summer months. In October, AFSC finalized hail claims in 24 days and completed approvals in three days, both ahead of turnaround time goals. During November, AFSC began including reports on post-harvest claims, of which 80.4 per cent were filed-to-inspected within 45 days and 86 per cent were approved within 15 days, again beating corporate turnaround goals. By the end of December, these numbers shifted marginally, with 81.5 per cent of claims inspected within 45 days and 79 per cent of claims approved within 15 days.

AgriInsurance Operating Results

	2015-16 Target	2015-16 (3rd qtr.)	2014-15 (Annual)	2013-14 (Annual)	2012-13 (Annual)
Number of policies	29,618	29,273	29,028	31,028	31,079
Number of acres insured (M)	34.47	35.58	34.96	36	34.87
Amount of risk ($M)	7,134.45	7,810.84	6,799.33	8,611.45	8,991.73
Amount of premium ($M)	611.00	618.02	584.83	780.43	662.57
Amount of admin cost ($M)	39.12	28.55	38.40	34.41	34.47
Indemnities ($M)	N/A	519.69	372.65	308.56	551.20
Loss to premium ratio (%)	N/A	84.09	63.72	39.50	83.20
Operating surplus [deficit] ($M)	N/A	87.55	229.03	469.09	102.64

M=Million
N/A = Information not applicable
Note: Insurance performance measures include information for base programs as well as endorsements.

AgriInsurance Delivery Efficiency

	2015-16 Target	2015-16 (3rd qtr.)	2014-15 (Annual)	2013-14 (Annual)	2012-13 (Annual)
Admin./policy ($)	1,370	977	1,324	1,109	1,108
Admin./acre ($)	1.13	0.80	1.10	0.96	0.99
Admin./risk (%)	0.55	0.39	0.57	0.40	0.38
Admin./premium (%)	6.50	4.62	6.57	4.41	5.20

Straight Hail Operating Results

Straight Hail claims and indemnities were finalized and paid to clients during the first part of the quarter. There were 3,757 clients that had 3.8 million acres covered by the Straight Hail Insurance Program, creating $546.5 million in insured risk and generating premiums of $45.1 million. In total, 1,200 clients experienced a loss that resulted in payments of $32.6 million and a 72.3 per cent loss-to-premium ratio. During the same quarter last year, 1,713 out of 4,648 clients reported a loss, resulting in payments of $61.2 million and a loss-to-premium ratio of 109.3 per cent.

	2015-16 (3rd qtr.)	2014-15 (Annual)	2013-14 (Annual)	2012-13 (Annual)
Number of policies	3,757	4,648	4,895	5,815
Number of acres insured (M)	3.80	4.84	4.94	5.59
Amount of policy risk ($M)	546.53	711.42	589.83	625.90
Amount of premium ($M)	45.13	56.04	47.00	47.18
Admin. cost ($M)	1.33	2.31	2.22	3.10
Indemnities ($M)	32.64	61.24	37.76	58.52
Loss to premium ratio (%)	72.34	109	80	124
Operating surplus [deficit] ($M)	8.91	[8.84]	4.49	[8.17]

M=Million

Western Livestock Price Insurance Program (WLPIP)

For WLPIP, the third quarter of 2015-2016 was quite active. High volumes of settlements within both the Calf and Feeder products combined with the longest continual decline in local market prices since the bovine spongiform encephalopathy (BSE) crisis of 2003 made indemnities top-of-mind for all WLPIP policy holders.

All three cattle programs were in indemnity positions during the third quarter, with Calf paying out a total of $3.97 million to Alberta clients. The lowest settlement index recorded throughout the fall occurred on December 21, 2015 - the last Calf settlement of the year -and came in at $232.55/cwt. The highest possible indemnity for all Calf policies occurred the week prior, when coverage, available at $266/cwt (on May 28th), combined with December 14's $237.85 settlement figure for a total potential payout of $28.15/cwt. While policies continued to settle throughout the fall, no policies were purchased in February 2015 at coverage levels high enough to award indemnities when settled. Loss-to-premium ratios on the Calf program came in at 188 per cent, which is near what was experienced in 2012-2013.

The Feeder program saw purchase volumes trend lower than in previous years, but clients consistently monitored coverage levels to make sure they were prepared to purchase once the numbers moved in their favour. Fall 2015 saw the cash market outperform futures contract values, creating a distinction between the prices that buyers were procuring in the cattle market and what they expected to sell them for in the future. This created a gap between offered coverage levels and the cost of production, which resulted in a reduction in buying interest.

Feeder policies paid a total of $172,000 in indemnity, while the Fed program paid a total of $284,000. Loss-to-premium ratios were 12 per cent and 50 per cent respectively, with the Fed program showing a more pronounced loss due to policies that were paid at high indemnities late in the quarter.

All three of our program components (price, currency, and basis) were moving targets in the third quarter, further exemplifying the efficacy of our program. Price was on a bearish trend for most of the quarter, bottoming out at the end of December. Currency was not spared from movement either, as we saw a significant decline in our loonie throughout the quarter. This in itself is a key support to Canadian cattle prices, because without the decline in the Canadian dollar, local cash prices would have slid substantially below where they actually did. Basis remained the hardest component to predict; cattle owners struggled with this as the cash market shifted and talks of repealed Country of Origin Labelling (COOL) continued to resurface.

WLPIP Operating Results

	Policy option	Policies	Premiums ($,000)	Liabilities ($,000)	Indemnity ($,000)	Loss to premium
Alberta 2015-16 Third Quarter						
	Calf	1,127	2,103.70	215,630.69	3,968.00	189%
	Fed	51	570.44	49,859.76	286.00	50%
	Feeder	400	1,459.65	85,461.75	172.00	12%
	Hog	3	3.51	90.85	-	0%
Total		**1,581**	**4,137.30**	**351,043.06**	**4,426.00**	**107%**
Alberta 2014-15						
	Calf	2,566	5,123.00	358,773.00	160.00	3%
	Fed	304	2,738.00	194,913.00	87.00	3%
	Feeder	1,875	12,869.00	695,333.00	2.00	0%
	Hog	$0	-	-	-	0%
Total		**4,745**	**20,730.00**	**1,249,019.00**	**249.00**	**0%**
Alberta 2013-14						
	Calf	1,528	3,454.00	196,916.00	-	0%
	Fed	1,004	5,021.00	566,346.00	2,083.00	41%
	Feeder	3,454	14,917.00	1,005,627.00	1,122.00	8%
	Hog	16	42.00	1,347.00	39.00	93%
Total		**6,002**	**23,433.00**	**1,770,236.00**	**3,244.00**	**14%**
Alberta 2012-13						
	Calf	273	489.00	35,948.00	946.00	193%
	Fed	289	1,750.00	175,951.00	4,816.00	275%
	Feeder	1,003	6,240.00	385,940.00	17,605.00	282%
	Hog	6	11.00	311.00	8.00	72%
Total		**1,571**	**8,490.00**	**598,151.00**	**23,375.00**	**275%**

** To be determined as information becomes available.
N/A = Information not applicable

AgriInvest

By December 31, 2015, 26,455 Alberta producers deposited $544 million to their AgriInvest accounts. While the figure started at $551 million in October and increased to $552 million by early November, the final tally was impacted by client withdrawals.

For the 2014 year, AgriInvest had 18,967 participants who contributed $40.5 million, compared to 21,920 participants who contributed $61.4 million for the 2013 year.

Since the inception of AgriInvest in 2007, Alberta producers have received $392 million in government funds.

AgriInvest Balance of Funds on Deposit as of September 30

Year	Number of Producers Depositing	Total Value of Contributions by Producer ($) M	Total Value of Contributions by Government ($) M	Amount on Deposit ($) M
2014	18,967	40,535	40,535	544
2013	21,920	61,422	61,422	480
2012	22,662	90,360	90,360	390
2011	22,743	76,974	76,974	316

M=Million

AgriStability

In the third quarter, AgriStability focused on processing 2014 claims. As of December 31, 2015, 71 per cent of the 12,740 claims received for the 2014 program year were completed, totaling $18.4 million in benefits paid to participants. The amount of opt-outs received in 2014 was half of those received in 2013.

Grain prices saw a moderate increase over the 2014 production year; however, did not return to early-2013 levels. The 2014 year also saw a marginal decline in crop yields in comparison to the prior year.

During 2013, cattle prices were relatively consistent throughout. However, prices began to climb in early 2014, and continued upward before peaking in the last quarter of the year.

Hog prices showed an overall increase in 2014, but by the end of the year they returned to levels only slightly above those at the start of the year.

AgriStability endeavours to complete 80 per cent of payment claims within 45 days and 80 per cent of non-payment claims within 65 days. Year-to-date results are 72 per cent for payment claims and 96 per cent for non-payment claims.

The average support level increased from $194,092 in 2013 to $206,234 in 2014.

AFSC AgriStability Cost Effectiveness

	2015-16 (3rd qtr.)	2014-15 (Annual)	2013-14 (Annual)	2012-13 (Annual)
Admin. cost ($M)*	11.71	$18.41	$18.01	$19.07
Less AgriInvest ($M)	-1.06	-1.52	-1.55	-1.77
Net AgriStability admin cost ($M)	10.65	$16.89	$16.46	$17.30
Number of files processed	9080	15,244	17,825	21,458
Cost per file ($)	1173	$1,108	$923	$806

M=Million
* Income Stabilization administrative costs include Alberta's share of AgriInvest administration costs, which Benchmarks do not.
** To be determined as information becomes available.

AgriStability Claims by Industry

Industry	Agristability claims ($M)	Denied AgriStability claims ($M)	AgriStability claims > $0 ($M)	AgriStability ($M)
2014 Program Year (3rd Quarter)				
Livestock	2,538	25	83	1.65
Crop	3,856	23	420	16.59
Other	454	12	14	0.20
Total	6,848	60	517	18.44
2013 Program Year				
Livestock	4,168	71	682	40.85
Crop	7,658	149	1007	19.18
Other	878	49	85	2.02
Total	12,704	269	1,774	62.05
2012 Program Year				
Livestock	5,107	133	779	35.97
Crop	8,836	206	591	14.90
Other	1,090	57	85	1.04
Total	15,033	396	1,455	51.91
2011 Program Year				
Livestock	6,680	182	870	23.56
Crop	9,917	359	1,228	24.83
Other	1,358	71	124	1.62
Total	17,955	612	2,222	50.01

M=Million